

VZCZCXR05053

RR RUEHAO RUEHCD RUEHGD RUEHHO RUEHMC RUEHNG RUEHNL RUEHRD RUEHRS

RUEHTM

DE RUEHCV #0027/01 0111908

ZNY CCCCC ZZH

R 111907Z JAN 10

FM AMEMBASSY CARACAS

TO RUEHC/SECSTATE WASHDC 0263

INFO WESTERN HEMISPHERIC AFFAIRS DIPL POSTS

RHEBAAA/DEPT OF ENERGY WASHINGTON DC

RHEHAAA/NATIONAL SECURITY COUNCIL WASHINGTON DC

RHMFISS/HQ USSOUTHCOM MIAMI FL

RUCPDOC/DEPT OF COMMERCE WASHINGTON DC

RUEATRS/DEPT OF TREASURY WASHINGTON DC

C O N F I D E N T I A L SECTION 01 OF 04 CARACAS 000027

SIPDIS

ENERGY FOR CDAY AND ALOCKWOOD

HQ SOUTHCOM ALSO FOR POLAD

TREASURY FOR MKACZMAREK

NSC FOR DRESTREPO AND LROSSELLO

USDOC FOR 4332 MAC/ITA/WH/JLAO

AMEMBASSY BRIDGETOWN PASS TO AMEMBASSY GRENADA

AMEMBASSY OTTAWA PASS TO AMCONSUL QUEBEC

AMEMBASSY BRASILIA PASS TO AMCONSUL RECIFE

E.O. 12958: DECL: 2020/01/11

TAGS: [ECON](#) [EFIN](#) [VE](#) [PGOV](#) [EPET](#) [EINV](#) [ETRD](#) [EAIR](#) [CVIS](#)

SUBJECT: Venezuela: Chavez Devlaues Bolivar and Creates a Second Rate Tier

REF: 09 CARACAS 304; 09 CARACAS 564; 09 CARACAS 87; 09 CARACAS 368
09 CARACAS 1311; 08 CARACAS 838

CLASSIFIED BY: DUDDY, AMBASSADOR, DOS, AMB; REASON: 1.4(B), (D)

¶1. (SBU) Summary: President Chavez announced a devaluation of the bolivar (Bs) on January 8. Instead of an official exchange rate of 2.15 Bs/USD, there will be two rates: an "official" rate of 2.6 Bs/USD (a devaluation of 17 percent) and a "dolC!r petrolero" rate of 4.3 Bs/USD (a 50 percent devaluation). The first rate will apply to imports of essential items like food and health products and to certain public-sector transactions. The latter will apply to other imports and to most other categories of foreign exchange transactions made through CADIVI, the Venezuelan government's (GBRV's) foreign currency board. When selling dollars to the Central Bank, PDVSA will receive a weighted rate between 2.6 and 4.3 that takes into account the weighted rate of currency sales by the Central Bank. By devaluing, President Chavez is prioritizing fiscal and budgetary relief for the GBRV and PDVSA over inflation and is seeking to stimulate growth. While significant in the short term, the devaluation does not fundamentally change Venezuela's economic trajectory. End summary.

The Announcement and Its Official Justification

¶2. (U) President Chavez announced the devaluation in a January 8 cabinet meeting broadcast on state television. Unlike other important economic announcements Chavez has made, the broadcast was not mandatory for other local stations. Chavez said the official exchange rate would change from 2.15 Bs/USD to 2.6 Bs/USD as of January 11. (Note: This change represents a 17 percent devaluation, though Chavez did not use the word devaluation. End note.) He said this rate would apply to imports of food, health products, machines and equipment, and science and technology; to imports made by the public sector; to remittances to family members; to hard currency for students studying abroad; to embassies and consulates in Venezuela; to retired pensioners; and other special cases. He announced the creation of a second exchange rate tier to be set at 4.3 Bs/USD (a 50 percent devaluation), which would apply to "everything else." (Note: This "everything else" includes repatriation of dividends and reimbursement of international airlines for tickets sold in Bs, as

well as other categories of imports. End note.) In a subsequent interview, Minister of Finance and Economy Ali Rodriguez said the 4.3 rate would apply to the sale of dollars by PDVSA to the Venezuelan Central Bank (BCV).

¶3. (SBU) A GBRV decree issued in the Official Gazette (dated January 8 but available January 11) codified these announced changes with several important exceptions. Most importantly, in direct contrast to what Rodriguez said, it essentially establishes a weighted exchange rate for PDVSA sales of dollars to the BCV. Specifically, it gives the BCV discretion to choose between 2.6 and 4.3 for a given transaction, "with attention" to the proportion of currency sold by the BCV at these rates and with the 2.6 rate prevailing for a minimum of 30 percent of the sales. (Note: The maximum rate PDVSA would get, therefore, is 3.8 Bs/USD. End note.) Private sector exporters and non-petroleum public sector exporters would receive 4.3 Bs/USD when selling their dollar earnings to the BCV. The decree says that foreign exchange transactions pending at the BCV before January 11 will be carried out at the prior official rate (2.15 Bs/USD), as will banks' requests for reimbursement for foreign exchange sold to customers for credit card purchases before January 11 in accordance with existing CADIVI regulations. (Note: Our reading of these provisions suggests that companies that had requests pending at CADIVI (e.g., for repatriation of dividends or for final authorization for imports) that had not yet received

CARACAS 00000027 002 OF 004

CADIVI approval will not be able to receive the 2.15 rate for these transactions. End note.)

¶4. (U) Chavez and his ministers made several other relevant announcements. Chavez said the BCV and the executive branch "will intervene" in the parallel foreign exchange market ("the so-called exchange market" which is "like a third tier") to "eliminate the speculative increase in hard currency." BCV president Nelson Merentes said the BCV would transfer USD 7 billion in international reserves (out of USD 35 billion) to the GBRV's quasifiscal fund Fonden. Finally, Rodriguez said exporters would now be allowed to keep 30 percent of their export earnings in hard currency rather than 10 percent. On January 10 in his regular Sunday broadcast, Chavez said "there is absolutely no reason for anyone to be raising prices now," adding that he was capable of taking over "any business, whatever the size, that gets into the game of the bourgeois speculators."

¶5. (U) The primary justification given by President Chavez and his ministers for the devaluation was to stimulate the economy. Chavez said the measures had various objectives, including "reinvigorating the productive economy, strengthening the Venezuelan economy, slowing down imports not strictly necessary, at the same time stimulating exports, substituting imports, and also invigorating, orienting, and stimulating production toward exports." Minister of Planning and Development Jorge Giordani echoed these objectives, stressing the importance of "strengthening non-traditional exports, particularly for the private sector" and, "on the other hand, making unnecessary imports more expensive." He argued that the inflationary impact of the measures would be "relatively small" for essential consumption goods and noted that economic growth was more important. In a subsequent interview, Rodriguez estimated the impact on inflation would be "three to five percentage points." He justified the devaluation as a step in breaking Venezuela's "extreme dependency on petroleum exports." He contrasted this devaluation with others made by previous governments, saying previous devaluations were needed to "cover fiscal deficits," whereas this devaluation was needed solely to correct the price of the dollar given the changes in other prices (i.e., inflation) since the last time the currency was devalued (in 2005).

The Impact: Inflation, Fiscal Relief, and Perhaps Growth

¶6. (C) Estimating the economic impact of these measures is difficult because Venezuela's economy was already experiencing a de-facto devaluation as many transactions shifted from the official to the parallel rate given the reduction in CADIVI authorizations in 2009 (ref A). As currently conceived, the measures will be inflationary and will also provide significant fiscal and budgetary relief to the GBRV and PDVSA. Imports make up a significant percentage of what Venezuelans consume, and the prices of imported goods are bound to rise as the weighted exchange rate rises (assuming the parallel exchange rate remains roughly the same and the percentage of goods imported through the parallel rate versus one of the two tiers remains the same). By using the lower tier of 2.6 for imports of essential goods like food and medicine, the GBRV hopes to keep inflation lower for these items. The transfer of USD 7 billion in reserves to Fonden, which had been expected, will also increase monetary liquidity (and, more immediately, reduce the liquidity to reserves ratio) and thus inflation. While Chavez's threat to take over businesses that overcharge people may forestall large immediate price increases, it does not represent a credible strategy to fight inflation.

¶7. (SBU) At the same time, the devaluation will provide

CARACAS 00000027 003 OF 004

significant budgetary relief to PDVSA and fiscal relief to the GBRV. PDVSA's cash flow problems had been obvious for some time (ref C), and the devaluation will significantly increase its revenue in bolivars (with the exact percentage increase depending on the weighted exchange rate it receives), giving it more money to pay local obligations and increasing its tax contribution (as measured in bolivars) to the GBRV. As a result, both entities will have a lesser need to issue debt in 2010 (and indeed the prices of sovereign GBRV bonds rose on news of the devaluation). The extent to which the devaluation will have the positive impact on economic growth is hard to predict. The devaluation will increase the relative price incentive for local production over imports, but there are many other significant impediments to local investment that it will not address (ref C).

The Impact: The Parallel Exchange Rate

¶8. (C) Another unknown is how the devaluation will impact the parallel exchange rate. The bolivar depreciated slightly on January 8 as speculation that a devaluation would be announced grew. In the near term, the rate may well be driven by the GBRV interventions to which Chavez referred. The BCV has reportedly been buying dollar-denominated assets it can use to intervene in the parallel market, and if it unveils a plausible strategy for intervention in the coming weeks the parallel rate may well go down (i.e., the bolivar appreciate). On the other hand, if the GBRV resorts to more coercive measures (i.e., threatening importers who use the parallel rate, as several comments made by President Chavez suggested might be the case) or Venezuelans rush to buy dollars, the rate could go up. Over the medium term, it will be hard for the GBRV to keep the rate from rising given high and increasing inflation.

The Impact: Specific U.S. Interests

¶9. (SBU) The devaluation has important implications for U.S. interests. U.S. companies, including those operating in Venezuela and those exporting to Venezuela, will be affected. U.S. exporters

can expect some reduced demand for their products, though the amount of the reduction will be tempered by the difficulty of increasing local production and by the fact that many of the transactions were already occurring at the parallel rate. U.S. companies operating in Venezuela will have to mark down the dollar value of their bolivar-denominated assets as they change the exchange rate they use for accounting purposes (indeed, some already have taken charges to their balance sheets). Venezuelan travel to and spending in the U.S. is likely to be reduced, as the GBRV is essentially halving the subsidy it provides to travelers. Finally, the devaluation has operational consequences for the Embassy which we will discuss with the Department in other channels.

Comment: Why, Why Now, and To What End?

¶10. (C) While a de-facto devaluation was ongoing throughout 2009 and an official devaluation was inevitable at some point, many local analysts did not expect an official devaluation until after parliamentary elections scheduled for September 2010 for reasons outlined in ref A. Why did President Chavez decide to devalue now? We believe there are two reasons. First, he probably felt an urgent need to do something to stimulate the economy after greater than expected contractions in the third and fourth quarter of 2009. Second, the devaluation will provide the GBRV and PDVSA additional

CARACAS 00000027 004 OF 004

resources in bolivars for spending in advance of the parliamentary elections. Chavez is obviously cognizant of the inflationary impact of devaluation and is seeking to mitigate the impact on his base by having the BCV subsidize essential items and by threatening vendors who increase prices. Chavez and his ministers are also seeking to minimize the political cost as they introduce the measure to the Venezuelan public, as evidenced by Chavez's avoidance of the word "devaluation" and the timing and nature of the announcement. Whether they succeed in minimizing the political cost remains to be seen. As Chavez is well aware, Venezuelans associate devaluations with inflation, recession, and unpopular economic measures, and it will now be more difficult for Chavez to blame the country's economic woes on external factors, past governments, or the local "bourgeois".

¶11. (C) We do not believe the devaluation changes the medium and long-term trajectory of the Venezuelan economy as we have outlined it previously (ref C). Previous GBRV plans to stimulate local production have failed because they have not addressed the root causes of low investment (refs D,E, and F). In the absence of a credible plan to reduce inflation and stimulate local investment, the change in relative prices (between imported and locally produced goods) introduced by the devaluation, while significant, is unlikely to produce a sustained increase in local production. With increased inflation, relative prices will revert to what they had been, and another devaluation, be it de-facto or official, will be necessary. End comment.

CAULFIELD